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PRIVATELY FINANCED INFRASTRUCTURE PROJECTS

Draft chapters of a legislative guide on privately financed infrastructure projects

Report of the Secretary-General

Addendum

VI. END OF PROJECT TERM, EXTENSION AND TERMINATION

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LEGISLATIVE RECOMMENDATIONS

1. Extension of the project agreement (see paras. 2-4)

1. The host country may wish to provide that the project agreement may be extended under exceptional circumstances, such as:

(a) To compensate for project suspension or loss of profit due to the occurrence of impeding events;

(b) To compensate for project suspension brought about by acts of the contracting authority or other government agencies;

(c) To allow the concessionaire to recover the cost of extraordinary work required on the facility and which the concessionaire would not be able to amortize during the normal term of the project agreement without unreasonable tariff increase.

2. Termination by the contracting authority (see paras. 10-23)

2. The host country may wish to provide that the contracting authority may terminate the project agreement:

(a) In the event of serious default by the concessionaire, in the circumstances provided in the project agreement, in particular if it can no longer be reasonably expected that the concessionaire will be able or willing to perform its obligations;

(b) In the event that the concessionaire is declared insolvent or bankrupt;

(c) For the contracting authority's convenience, subject to payment of fair compensation to the concessionaire.

3. The host country may wish to provide that before terminating the project agreement the contracting authority should, as appropriate:

(a) Grant the concessionaire an additional period of time to perform the obligation or remedy the consequences of its default;

(b) Give notice to the concessionaire's lenders and sureties, as appropriate, to remedy the consequences of the concessionaire's default within a reasonable time or to appoint a substitute concessionaire under the terms of their agreements with the contracting authority.

3. Termination by the concessionaire (see paras. 24-29)

4. The host country may wish to provide that the concessionaire may terminate the project agreement:

(a) In the event of serious default by the contracting authority or other agency of the host Government as regards the fulfilment of their obligations under the project agreement;

(b) In the event that the concessionaire's performance is rendered substantially more onerous as a result of variation orders made by the contracting authority or unforeseen changes in conditions and that the parties have failed to agree on an appropriate revision of the project agreement.

4. **Termination by either party (see paras. 30 and 31)**

5. The host country may wish to provide that the project agreement may also be terminated:

(a) In the event that the performance by either party is rendered impossible by the occurrence of exempting impediments;

(b) By mutual consent.

5. **Transfer of assets to the contracting authority (see paras. 34 and 35)**

6. The host country may wish to provide that the project agreement should:

(a) Identify the categories of assets that the concessionaire is required to transfer to the contracting authority upon expiry or termination of the project agreement and lay down the criteria for establishing, as appropriate, the compensation to which the concessionaire may be entitled in that respect;

(b) Identify the categories of assets that the contracting authority, at its option, may purchase from the concessionaire against payment of their fair market value;

(c) Identify the categories of assets that the concessionaire may freely remove or dispose of upon expiry or termination of the project agreement.

6. **Transfer of assets to a new concessionaire (see para. 36)**

7. The host country may wish to provide that the concessionaire may be required to make any of the assets referred to in subparagraphs 6 (a) and (b) above available to a new concessionaire against adequate compensation for those assets which have not been fully amortized during the project period.

7. **Financial arrangements upon termination (see paras. 39-45)**

8. The host country may wish to provide that the project agreement should stipulate how compensation due to the concessionaire in the event of termination of the project agreement is to be calculated, including:

(a) Compensation for the fair value of works performed under the project agreement if the project agreement is terminated for reasons attributable to the concessionaire;

(b) Compensation for the fair value of the works performed by as well as for the loss caused to the concessionaire, including lost profits, if the project agreement is terminated for reasons attributable to the contracting authority;

(c) Compensation for the fair value of the works performed by the concessionaire and other compensation that may be appropriate in the circumstances, if the project agreement is terminated due to the occurrence of exempting impediments or for the contracting authority's convenience.

8. **Wind-up and transitional measures (see paras. 46-58)**

9. The host country may wish to provide that the project agreement should set out the rights and obligations of the parties with respect to:

(a) The transfer of technology required for the operation of the facility;

(b) The training of the contracting authority's personnel in the operation and maintenance of the facility;

(c) The provision, by the concessionaire, of operation and maintenance services and the supply of spare parts, if required, for a reasonable period after the transfer of the facility to the contracting authority.

NOTES ON THE LEGISLATIVE RECOMMENDATIONS

A. General remarks

1. Most privately financed infrastructure projects are undertaken for a certain period, at the end of which the concessionaire transfers to the contracting authority responsibility for the operation of the infrastructure facility. The elements to be taken into account when establishing the concession period have been considered elsewhere in the *Guide* (see chap. IV, "The project agreement", ___). This chapter deals with issues arising in connection with the expiry or termination of the project agreement, which in many countries have been addressed in statutory provisions. Section B deals with the question of whether and under what circumstances the project agreement may be extended (see paras. 2-4). Section C considers circumstances that may authorize the termination of the project agreement prior to the expiry of its term (see paras. 5-31). Lastly, section D deals with the consequences of the expiry or termination of the project agreement, including the transfer of project assets and the compensation to which either party may be entitled upon termination and provisions for the wind-up of the project (see paras. 32-58).

B. Extension of the project agreement

2. In the contracting practice of some countries, the contracting authority and the concessionaire may agree on one or more extensions of the concession period. More often, however, domestic laws only authorize an extension of the project agreement under exceptional circumstances. In this case, upon expiry of the project agreement the contracting authority is normally required to begin a new selection process to select a new concessionaire, normally using the same procedures applied to select the concessionaire whose concession has expired (see chap. III, "Selection of the concessionaire", ___).

3. A number of countries have found it useful to require that exclusive concessions be rebid from time to time rather than freely extended by the parties. Periodic rebidding may give the concessionaire strong performance incentives. The period between the initial award and the first (and subsequent) rebidding should take into account the level of investment and other risks faced by the concessionaire. For example, for solid waste collection concessions not requiring heavy fixed investments, the periodicity may be relatively short (e.g. three to five years), whereas longer periods may be desirable for power or water distribution concessions, for example. In most countries, rebidding coincides with the end of the project term, but in others a concession may be granted for a long period (e.g. 99 years), with periodic rebidding (e.g. every 10 or 15 years). In the latter mechanism, which has been adopted in a few countries, the first rebidding occurs before the concessionaire has fully recouped its investments. As an incentive to the incumbent operator, some laws provide that the concessionaire may be given preference over other bidders in the award of subsequent concessions for the same activity. However, the concessionaire may have property rights that will need to be compensated for if it does not win the next bidding round, in which case all or part of the bidding proceeds may revert to the incumbent concessionaire. Requiring that the winning bidder should pay off the incumbent concessionaire for its property rights and for the investment not yet recovered reduces the longer-term risk faced by investors and lenders and provides them a valuable exit option.

4. Notwithstanding the above, it is advisable not to exclude entirely the option to negotiate an extension of the concession period under exceptional circumstances. The duration of an infrastructure project is one of the main factors taken into account in the negotiation of financial arrangements and has a direct impact on the price of the services provided by the concessionaire. The parties may find that an extension of the project agreement (as a substitute for, or combined with, other compensation mechanisms) may be a useful option to deal with unexpected or extraordinary circumstances arising during the life of the project. Such circumstances may include any of the following: extension to compensate for project suspension or loss of profit due to the

occurrence of impeding events (see chap. V, "Infrastructure development and operation", ___); extension to compensate for project suspension brought about by the contracting authority or other government agencies (see chap. V, "Infrastructure development and operation", ___); or extension to allow the concessionaire to recover the cost of extraordinary work required to be done on the facility and which the concessionaire would not be able to amortize during the normal term of the project agreement without unreasonable tariff increases (see chap. V, "Infrastructure development and operation", ___). For purposes of transparency and accountability, in some countries the extension of the concession period is subject to a global cumulative limit or requires the approval of a specially designated authority of the Government.

C. Termination

5. The grounds for termination of the project agreement before the expiry of its term and the consequences of early termination are often dealt with in domestic legislation. Usually the law authorizes the parties to terminate the project agreement following the occurrence of certain types of event. The main interest of all parties involved in a privately financed infrastructure project is to ensure the satisfactory completion of the facility and the continuous and orderly provision of the relevant public service. Given the serious consequences of termination, as provision of the service may be interrupted or even discontinued, termination should under most circumstances be regarded as a measure of last resort. The conditions for the exercise of this right by either party should be carefully considered. While they may not need to be identical, it is generally desirable to achieve a broadly equitable balance of rights and conditions regarding termination for both parties.

6. In addition to identifying the circumstances or types of event that may give rise to a termination right, it is advisable for the parties to consider appropriate procedures to establish whether there are valid grounds for terminating the project agreement. Of particular importance is the question whether the project agreement may be unilaterally terminated or whether termination requires a decision by a judicial or other dispute settlement body (see chap. VIII, "Settlement of disputes", ___).

7. The concessionaire is usually not allowed the right to terminate the project agreement unilaterally, but in the general contracting practice of some countries such a right may be exercised by government agencies, subject to payment of compensation. In some countries, however, an exception is made in the case of public services concessions, whose contractual nature is found to be incompatible with unilateral termination rights. Lastly, some legal systems do not recognize unilateral termination rights for government agencies. The contracting authority may find that a unilateral termination right is a powerful tool to encourage performance by the concessionaire. It may also find that unilateral termination rights save time in taking the necessary measures to ensure the continuity of the service upon irremediable default by the concessionaire. However, project sponsors and lenders would be concerned about the risk of premature or unjustified termination by the contracting authority, even where a decision to terminate might be subject to review through the dispute settlement mechanism. It should also be noted that giving the contracting authority the unilateral right to terminate the project agreement would not be an adequate substitute for well-designed contractual mechanisms of performance monitoring or for appropriate guarantees of performance (see chap. V, "Infrastructure development and operation", ___).

8. Provisions concerning termination should therefore be brought into line with the remedies for default provided in the project agreement. In particular, it is useful to distinguish the conditions for termination from those for step-in by the contracting authority (see chap. V, "Infrastructure development and operation", ___). It is also important to consider the contracting authority's termination rights against the background of the financing agreements negotiated by the concessionaire with its lenders. In most cases, events that may lead to the termination of the project agreement would also constitute events of default under the loan agreements, with the consequence that the entire outstanding debt of the concessionaire may fall due immediately. It would thus be useful to attempt to avoid the risk of termination by recourse first to a direct agreement, which would allow

the lenders to substitute another concessionaire when termination of the project agreement with the original concessionaire appears imminent (see chap. V, "Infrastructure development and operation", ___).

9. In the light of the above, it is generally advisable to provide that the termination of the project agreement should in most cases require a final finding by the dispute settlement body stipulated in the agreement. Such a requirement would reduce concerns about premature or unjustified recourse to termination. At the same time, it would not preclude the taking of appropriate measures to ensure the continuity of the service, pending the final decision of the dispute settlement body, as long as contractual remedies for default, such as step-in rights for the contracting authority and the lenders, are provided in the project agreement.

1. Termination by the contracting authority

10. The contracting authority's termination rights usually relate to three categories of circumstances: serious default by the concessionaire; insolvency or bankruptcy of the concessionaire; and termination for the contracting authority's convenience.

(a) Serious default by the concessionaire

11. A number of national laws give the contracting authority the right to terminate the project agreement in the event of default by the concessionaire. Because of the disruptive effects of termination and in the interest of preserving the continuity of the service, it is not advisable to regard termination as a sanction for each and any instance of unsatisfactory performance by the concessionaire. On the contrary, it is generally advisable to resort to the extreme remedy of termination only in cases of "particularly serious" or "repeated" failures to perform, especially when it can no longer be reasonably expected that the concessionaire will be able or willing to perform under the project agreement. Many legal systems use specific technical expressions to refer to situations where the degree of default by one contracting party is of such a nature that the other party may terminate their contractual relation before the expiry of its term (e.g. "fundamental breach", "material breach" or similar expressions). Such situations are referred to in the *Guide* as "serious default".

12. Circumscribing the possibility of termination to cases of serious default may give assurance to lenders and project sponsors that they will be protected against unreasonable or premature decisions by the contracting authority. The law may generally provide for the contracting authority's right to terminate the project agreement upon serious default by the concessionaire and leave it for the project agreement to define further the notion of serious default and, as appropriate, provide illustrative examples of it. From a practical point of view, it is not advisable to attempt, by statute or in the project agreement, to provide an exhaustive list of the events that justify termination.

13. As a general rule, it is desirable that the concessionaire be granted an additional period of time to fulfil its obligations and to parry the consequences of its default prior to the contracting authority's resorting to remedies. For example, the concessionaire should be given notice specifying the nature of the relevant circumstances and requiring it to rectify them within a certain period. The possibility should also be given for the lenders and sureties, as the case may be, to parry the consequences of the concessionaire's default in accordance with the terms of a direct agreement between the lenders and the contracting authority or the terms of the performance bonds provided to the contracting authority (see chap. V, "Infrastructure development and operation", ___). The project agreement may also provide that, if the circumstances are not rectified before the expiry of the relevant period, the contracting authority may then terminate the project agreement, subject to first notifying the lenders and giving them an opportunity to exercise their right of substitution within a certain period in accordance with the relevant procedure provided in the direct agreement. However, reasonable deadlines need to be set, since the contracting authority cannot be expected to bear indefinitely the continuing cost of a situation of potential breach of agreement by the concessionaire. Furthermore, the procedures should be without prejudice to the

contracting authority's right to step in to avert the risk of disruption of service by the concessionaire (see chap. V, "Infrastructure development and operation", ___).

(i) Serious default before the beginning of construction

14. The concessionaire typically needs to accomplish a series of steps prior to undertaking construction works. Such requirements are often conceived as conditions to the entry into force of the project agreement. Examples of events that often justify the withdrawal of the concession at an early stage include the following:

(a) Failure to secure the required financial means, to sign the project agreement or to establish the project company within the established deadline;

(b) Failure to obtain licences or permits required for pursuing the activity that is the object of the concession;

(c) Failure to undertake the construction of the facility, to commence development of the project or to submit the plans and designs required within a set period of time from the award of the concession.

15. Termination should in principle be reserved for situations where the contracting authority may no longer reasonably expect that the selected concessionaire will take the necessary measures to commence execution of the project. In that connection, it is important for the contracting authority to take into account any circumstances that may excuse the concessionaire's delay in fulfilling its obligations. Furthermore, the concessionaire should not suffer the consequences of inaction or error on the part of the contracting authority or other government agencies. For instance, the termination of the project agreement would not normally be justified if the concessionaire's failure to obtain government licences and permits within the agreed schedule was not attributable to the concessionaire's own fault.

(ii) Serious default during the construction phase

16. Examples of events that may justify the termination of the project agreement during the construction phase include the following:

(a) Failure to observe building regulations, specifications or minimum design and performance standards and non-excusable failure to complete work within the agreed schedule;

(b) Failure to provide or renew the required guarantees in the agreed terms;

(c) Violation of essential statutory or contractual obligations, as provided in the project agreement.

17. Termination should be commensurate with the degree of default by the concessionaire and the consequences of default for the contracting authority. For instance, the contracting authority may have a legitimate interest in specifying a date when the construction must be completed and may therefore be justified in regarding a delay in completion as an event of default and hence a ground for termination. However, delay alone, in particular if it is not excessive in relation to the specifications of the project agreement, should not be sufficient reason for termination when the contracting authority is otherwise satisfied of the concessionaire's ability to complete the construction in accordance with the required quality standards and its commitment to doing so.

(iii) Serious default during the operational phase

18. Examples of particular instances of default that may justify the termination of the concession during the operational phase include any of the following:

(a) Serious failure to provide services in accordance with the statutory and contractual standards of quality;

(b) Non-excusable suspension or interruption of the provision of the service without prior consent from the contracting authority;

(c) Serious failure by the concessionaire to maintain the facility, its equipment and appurtenances in accordance with the agreed standards of quality or non-excusable delay in carrying out maintenance works in accordance with the agreed plans, schedules and timetables;

(d) Disregard of price control measures, if any, or other serious violation of rules, regulations or contractual provisions governing the provision of the service;

(e) Failure to comply with sanctions imposed by the contracting authority or the regulatory body, as appropriate, for infringements of the concessionaire's duties.

19. For the purpose of enhancing transparency and integrity in governmental matters, the laws of some countries also provide for the termination of project agreements if the concessionaire is guilty of tax fraud or other types of fraudulent acts, or if its agents or employees are involved in bribery of public officials and other corrupt practices (see also chap. VII, "Governing law", ___). In such cases it may be advisable to consider the extent to which the concessionaire actually initiates any such corrupt acts in order to influence the decisions of public officials in the concessionaire's favour or whether illegal payments are made following irresistible demands or threats by officials of the host country (a crime sometimes referred to as "extortion").

(b) Insolvency of the concessionaire

20. Infrastructure services typically need to be provided continuously and for that reason most domestic laws stipulate that the agreement may be terminated if the concessionaire is declared insolvent or bankrupt. In order to ensure the continuity of the service, the assets and property required to be handed over to the contracting authority may be excluded from the insolvency proceedings and the law may require prior governmental approval for any act of disposition by a liquidator or insolvency administrator of any categories of assets owned by the concessionaire.

21. In legal systems that allow the establishment of security interests over the concession itself (see chap. IV, "The project agreement", ___), the law usually provides that the contracting authority may, in consultation with the secured creditors, appoint a temporary administrator so as to ensure the continued provision of the relevant service, until the secured creditors admitted to the insolvency proceedings decide, upon the recommendation of the insolvency administrator, whether the activity should be pursued or whether the right to exploit the concession should be put to auction.

(c) Termination for convenience

22. In the contracting practice of some countries, government agencies procuring construction works traditionally retain the right to terminate the construction contract for convenience (i.e. without having to provide any justification other than that the termination is in the Government's interest). In some common law

jurisdictions, that right can only be exercised if expressly provided for in a statute or in the relevant contract. Several legal systems belonging to the civil law tradition also recognize a similar power of government agencies to terminate contracts for reasons of "public interest" or "general interest". In some countries, such a right may be implied in the Government's contracting authority, even in the absence of an explicit statutory or contractual provision to that effect. In so far as the authority to determine what constitutes public interest may lie within the Government's discretion, an unqualified right to terminate for reasons of public interest is comparable to a termination for the contracting authority's convenience. The Government's right to terminate for convenience or for reasons of public interest, in those legal systems which recognize it, is regarded as essential in order to preserve the Government's unfettered ability to exercise its functions affecting the public good.

23. Nevertheless, the conditions for the exercise of this right, and the consequences of doing so, should be carefully considered. A general and unqualified right to terminate for the contracting authority's convenience may represent an imponderable risk that neither the concessionaire nor the lenders may be ready to accept without sufficient guarantees that they will receive prompt and fair compensation for loss sustained. The possibility of termination for convenience, where contemplated, should therefore be made known to prospective investors at the earliest possible occasion and should be expressly mentioned in the draft project agreement circulated with the request for proposals (see chap. III, "Selection of the concessionaire", ___). The compensation due for termination for convenience may, in practice, cover items that are taken into account when calculating the compensation that is due for termination for serious default by the contracting authority (see para. 42). Furthermore, it is generally advisable to limit the exercise of the right of termination for convenience to exceptional situations where a compelling reason of public interest requires the termination of the project agreement (for example, where subsequent changes in governmental plans and policies require the integration of a project into a larger network or where changes in the contracting authority's plans require major project revisions that substantially affect the original design or the project's commercial feasibility under private operation). In particular, it is not advisable to regard the right of termination for convenience as a substitute for other contractual remedies in case of dissatisfaction with the concessionaire's performance (see chap. V, "Infrastructure development and operation", ___).

2. Termination by the concessionaire

24. While the contracting authority in some legal systems may retain an unqualified right to terminate the project agreement, the grounds for termination by the concessionaire are usually limited to serious default by the contracting authority or other exceptional situations and do not normally include a general right to terminate the project agreement at will.

(a) Serious default by the contracting authority

25. Pursuant to a rule of law followed in many legal systems, a party to a contract may withhold performance of its obligations in the event of breach by the other party. In some legal systems that rule does not apply to government contracts, however, and the law provides instead that government contractors are not excused from performing solely on the ground of breach by the contracting authority unless and until the contract is rescinded by a judicial or arbitral decision. Rules of this type may be intended to ensure the continuity of public services (see chap. V, "Infrastructure development and operation", ___).

26. It should be noted, however, that while the contracting authority may mitigate the consequences of default by the concessionaire by using its right to step in, the concessionaire does not usually have a comparable remedy. In the event of serious default by the contracting authority, the concessionaire may sustain considerable or even irreparable damage, depending on the time required to obtain a final decision releasing the concessionaire from its obligations under the project agreement. These circumstances underscore the importance of government guarantees in respect of obligations assumed by contracting authorities (see chap. II,

"Government support", ___) and the need for allowing the parties the choice of expeditious and effective dispute settlement mechanisms (see chap. VIII, "Settlement of disputes", ___).

27. In those legal systems where the contracting authority has the right to request modifications in the project, some laws give the concessionaire the right to terminate the project agreement if the contracting authority alters or modifies the original project in such a fashion as to cause a substantial increase in the amount of investment required and the parties fail to agree on the appropriate amount of compensation (see chap. V, "Infrastructure development and operation", ___).

28. In addition to serious default by the contracting authority itself, it may be equitable to authorize termination by the concessionaire should the latter be rendered unable to provide the service as a result of acts of government agencies other than the contracting authority, such as failure to provide certain measures of support required for the execution of the project agreement (see chap. II, "Government support", ___).

(b) Changes in conditions

29. Some legal systems allow the concessionaire to terminate the project agreement if the concessionaire's performance has been rendered substantially more onerous by the occurrence of an unforeseen change in conditions and the parties have failed to agree on an appropriate revision to adapt the project agreement to the changed conditions (see chap. V, "Infrastructure development and operation", ___).

3. Termination by either party

(a) Impediment of performance

30. Some laws provide that the parties may terminate the project agreement if the performance of their obligations is rendered permanently impossible as a result of a circumstance defined in the project agreement as an exempting impediment (see chap. V, "Infrastructure development and operation", ___). In that connection, it is advisable to provide in the project agreement that if the exempting impediment persists for a specified amount of time or if the cumulative duration of two or more exempting impediments exceeds a specified amount of time, the contract may be terminated by either party. If the execution of the project is further rendered impossible on legal grounds, for instance, because of changes in legislation or as a result of judicial decisions affecting the validity of the project agreement, such a termination right might not require any specified amount of time to elapse and might be exercised immediately upon the change of legislation or other legal obstacle becoming effective.

(b) Mutual consent

31. Lastly, some legal systems authorize the parties to terminate the project agreement by mutual consent, usually subject to the approval of a specified authority of the Government.

D. Consequences of expiry or termination of the project agreement

32. The concessionaire's right to operate the facility and to provide the relevant service typically finishes upon expiry of the project term or termination of the project agreement. This often requires the transfer of assets to the contracting authority or to another concessionaire who undertakes to operate the facility (see paras. 33-38). There may be important financial consequences that will need to be regulated in detail in the project agreement, in particular in the event of termination by either party (see paras. 39-45). The parties will also need to agree on various wind-up measures to ensure the orderly transfer of the responsibility for operating the facility and providing the service (see paras. 46-58).

1. Transfer of project-related assets

33. A number of laws provide that, upon termination of the concession, the assets and property originally made available to the concessionaire and other goods related to the project should revert to the contracting authority. However, there may be projects where the concessionaire is not required to hand over the assets to the contracting authority, for instance, because it owns those assets or because the assets are transferred directly from the concessionaire to another concessionaire who succeeds it in the provision of the service.

(a) Transfer of assets to the contracting authority

34. The laws of some countries place particular emphasis on the contracting authority's interest in the physical assets related to the project and generally require the handover to the contracting authority of all of them, whereas in other countries privately financed infrastructure projects are regarded primarily as a means for procuring services over a specified period, rather than for the construction of assets. Thus, the laws of the latter countries limit the concessionaire's handover obligations to particular categories of assets deemed to be necessary for ensuring the provision of the service. This difference in legislative approaches often reflects the varying role of the public and private sectors under different legal and economic systems, but may also be the result of practical considerations on the part of the contracting authority.

35. One practical reason for the contracting authority to allow the concessionaire to retain certain assets at the end of the project period may be the desire to lower the cost at which the service would be provided. If the project assets are likely to have a residual value for the concessionaire and that value can be taken into account during the selection process, the contracting authority may expect that the price charged for the service will be lower. Indeed, if the concessionaire does not expect to have to cover the entire cost of the assets in the life of the project, but can cover part of it by selling them on, or using them for other purposes, after the project agreement expires, there is a possibility that the service may be provided at a lower cost than if the concessionaire had to cover all the costs in the life of the project. Moreover, certain assets may require such extensive refurbishing or technological upgrading at the end of the project period that it might not be cost-effective for the contracting authority to claim them. There may also be residual liabilities or consequential costs, for instance, because of liability for environmental damage or demolition costs. For these reasons, therefore, the laws of some countries do not contemplate an unqualified transfer of all assets to the contracting authority, but allow a distinction between three main categories of assets:

(a) *Assets that must be transferred to the contracting authority.* This category typically includes assets owned by the contracting authority or other agency of the host Government that were used by the concessionaire to provide the service concerned. They may include both facilities made available to the concessionaire by the contracting authority and new facilities built by the concessionaire pursuant to the project agreement. Some laws also require the transfer of assets, goods and property subsequently acquired by the concessionaire for the purpose of operating the facility, in particular where they become part of, or are permanently affixed to, the infrastructure facility to be handed over to the contracting authority. In the legal tradition of some countries, at the end of the project term, the concessionaire is required to transfer such assets free of any liens and encumbrances and at no cost to the contracting authority, except for compensation for improvements made to, or modernization of, the property for the purpose of ensuring the continuity of the service the cost of which has not yet been recovered by the concessionaire. In practice, such a rule presupposes the negotiation of a concession period sufficiently long and a level of revenue high enough for the concessionaire to fully amortize its investment and repay its debt. Other laws allow for more flexibility by authorizing the contracting authority to compensate the concessionaire for the residual value, if any, of assets built by the concessionaire;

(b) *Assets that may be purchased by the contracting authority, at its option.* This category usually includes assets originally owned by the concessionaire, or subsequently acquired by it, which, without being

indispensable or strictly necessary for the provision of the service, may enhance the convenience or efficiency of operating the facility or the quality of the service. If the contracting authority decides to exercise its option to purchase those assets, the concessionaire is normally entitled to compensation corresponding to their fair market value at the time. However, if those assets were expected to be fully amortized (i.e. the concessionaire's financing arrangements do not envisage any expectation of residual value of the assets), then the price paid might be only nominal. In the contracting practice of some countries, it is usual for contracting authorities to retain some security interest in such assets (such as a retention right), as a guarantee for their effective transfer;

(c) *Assets that remain the private property of the concessionaire*. These are assets owned by the concessionaire that do not fall under (b) above. Typically the contracting authority is not entitled to such assets, which may be freely removed or disposed of by the concessionaire.

(b) Transfer of assets to a new concessionaire

36. As indicated earlier, the contracting authority may wish to rebid the concession at the end of the project agreement, rather than to operate the facility itself (see para. 3). For that purpose, it may be useful for the law to require the concessionaire to make the assets available to a new concessionaire. In order to ensure an orderly transition and continuity of the service, the concessionaire should be required to cooperate with the new concessionaire in the handover. The transfer of assets between the concessionaires may require that some compensation be paid to the incumbent concessionaire, depending on whether or not the assets have been amortized during the life of the project:

(a) *Compensation at fair market value*. The concessionaire may be entitled to compensation for assets handed over to a successor concessionaire, in particular if its original proposal envisaged some residual value for the assets at the end of the project period, or if the financial proposal assumes significant revenue from third parties;

(b) *Nominal compensation*. If an element of residual value or third-party revenue is not envisaged in the concessionaire's financing, there may not be a prima facie reason for requiring a successor concessionaire to pay any compensation to the original concessionaire other than a nominal consideration. Indeed, if the concessionaire has achieved its expected return, a transfer payment from a successor concessionaire would be an additional cost that would ultimately have to be remunerated by the prices charged by the successor under the second agreement.

(c) Condition of assets at the time of transfer

37. Where assets are handed over to the contracting authority or transferred directly to a new concessionaire, the concessionaire is typically obligated to transfer them in good and operating condition, free of liens or encumbrances. The contracting authority's right to receive those assets in such operating condition is complemented in some laws by the obligation imposed upon the concessionaire to keep and transfer the project in such proper condition as prudent maintenance requires and to provide some sort of guarantee to that effect (see chap. V, "Infrastructure development and operation", ___). Where the contracting authority requires the assets to be returned in a prescribed condition, the required conditions should be reasonable. While it may be reasonable for the contracting authority to require that the assets have some defined period of residual life, it would not be reasonable to expect them to be as new.

38. It is advisable to devise procedures for ascertaining the condition of the assets that should be transferred to the contracting authority. It may be useful, for example, to establish a committee comprised of representatives of both the contracting authority and the concessionaire to establish whether the facilities are in the prescribed condition and conform to the relevant requirements set forth in the project agreement. The project agreement

may also provide for the appointment and terms of reference of such a committee, which may be given authority to request reasonable measures by the concessionaire to repair or eliminate any defects and deficiencies found in the facilities. It may be advisable to provide for a special inspection to take place one year prior to the termination of the concession, following which the contracting authority may require additional maintenance measures by the concessionaire so as to ensure that the goods are in proper condition at the time of the transfer. The contracting authority may wish to require that the concessionaire provide special guarantees for the satisfactory handover of the facilities (see chap. V, "Infrastructure development and operation", ___). The contracting authority might draw on such guarantees to pay the repair cost of damaged assets or property.

2. Financial arrangements upon termination

39. The early termination of the project agreement may occur before the concessionaire has been able to recover its investment, repay its debt and yield the expected profit, which may cause significant loss to the concessionaire. Loss may also be sustained by the contracting authority, which may need to make additional investment or incur considerable expense in order, for instance, to ensure the completion of the facility or the continued provision of the relevant services. In the light of these circumstances, project agreements typically contain extensive provisions dealing with the financial rights and obligations of the parties upon termination. The usual standards of compensation typically vary according to the various grounds for termination. Nevertheless, when negotiating compensation arrangements, the parties usually take into account the following factors:

(a) *Outstanding debt, equity investment and anticipated profit*. Project termination is typically included among the events of default in the concessionaire's loan agreements. Since loan agreements usually include a so-called "acceleration clause" whereby the entire debt may become due upon the occurrence of an event of default, the immediate loss sustained by the concessionaire upon termination of the project agreement may include the amount of debt then outstanding. Whether and to what extent such a loss might be compensated for by the contracting authority usually depends on the grounds for terminating the project agreement. Partial compensation may be limited to an amount corresponding to the value of works satisfactorily performed by the concessionaire, whereas full compensation may cover the entire outstanding debt. Another category of loss that is sometimes taken into account in compensation arrangements refers to loss of equity investment by the project sponsors, to the extent that such an investment has not yet been recovered at the time of termination. Lastly, termination also deprives the concessionaire of future profits that the facility may generate. Although lost profits are not usually regarded as actual damage, in exceptional circumstances, such as wrongful termination by the contracting authority, the current value of expected future profit may be included in the compensation due to the concessionaire;

(b) *Degree of completion, residual value and amortization of assets*. Contractual compensation schemes for various termination grounds typically include compensation commensurate with the degree of completion of the works at the time of termination. The value of the works is usually determined on the basis of the investment required for its construction (in particular if the termination takes place during the construction phase) or the "residual" value of the facility. The residual value means the market value of the infrastructure at the time of termination. Market value may be difficult to determine or even inexistent for certain types of physical infrastructure (such as bridges or roads) or for facilities whose operational life is close to expiry. Sometimes the residual value may be estimated taking into account the expected usefulness of the facility for the contracting authority. However, difficulties may be found in establishing the value of unfinished works, in particular if the amount of the investment still required by the contracting authority to render the facility operational would exceed the amount actually invested by the concessionaire. In any event, full payment of residual value seldom takes place, in particular where the project's revenue constitutes the sole remuneration for the concessionaire's investment. Thus, instead of full compensation for the facility's value, the concessionaire often receives compensation only for the residual value of assets that have not yet been fully

amortized at the time of termination. The notion of economic "amortization", in this context, refers to the gradual charging of the investment made against project revenue on the assumption that the facility would have no residual value at the end of the project term.

(a) Termination due to default by the concessionaire

40. The concessionaire is not usually entitled to damages in the event of termination due to its own default. In some cases the concessionaire may even be under an obligation to pay damages to the contracting authority, although, in practice, a defaulting concessionaire whose debts are declared due by its creditors would seldom have sufficient financial means left for actually paying such damages.

41. Termination due to default, even where it is regarded as a sanction for serious performance failures, should not result in the unjust enrichment of either party. Thus, termination does not necessarily entail a right for the contracting authority to take over assets without making any payment to the concessionaire. An equitable solution for dealing with this issue may be to distinguish between the different types of asset, according to the arrangements envisaged for them in the project agreement (see para. 35):

(a) *Assets that must be transferred to the contracting authority.* Where the project agreement requires the automatic transfer of project assets to the contracting authority at the end of the project agreement, termination on default does not usually entail the payment of compensation to the concessionaire for those assets, except for the residual value of work satisfactorily performed, to the extent that it has not yet been amortized by the concessionaire;

(b) *Assets that may be purchased by the contracting authority, at its option.* Some financial compensation may be adequate in cases where the contracting authority has an option to buy the assets at market value or for a nominal sum on expiry of the project agreement or the right to require that they be offered to the winner of a new project award. However, it may be legitimate to envisage a financial compensation that is less than the full value of the assets so as to stimulate performance by the concessionaire. By the same token, such compensation may not need to cover the full cost of repaying the concessionaire's outstanding debt. It is advisable to set forth the details of the formula for financial compensation in the project agreement (e.g. whether it covers the break-up value of the asset or the lesser of the outstanding debt and the alternative use value);

(c) *Assets that remain the private property of the concessionaire.* Where the project agreement does not provide for the handover of assets at the end of the concession period and alternative suppliers of the service can easily be found, the contracting authority may not have an interest in taking over the concessionaire's assets. However, where the contracting authority finds it necessary to take over the assets, even though not contemplated in the project agreement, it would be equitable to compensate the concessionaire for the fair market value of the assets. The project agreement may, however, provide that the compensation should be reduced by the amount incurred by the contracting authority in obtaining alternative service.

(b) Termination due to default by the contracting authority

42. The concessionaire is usually entitled to full compensation for loss sustained as a result of termination on grounds attributable to the contracting authority. The compensation due to the concessionaire usually includes compensation for the value of the works and installations, to the extent they have not already been amortized, as well as for the damage caused to the concessionaire, including lost profits, which are usually calculated on the basis of the concessionaire's revenue during previous financial years. The concessionaire may be entitled to full compensation of debt and equity, including debt service and lost profit.

(c) Termination on other grounds

43. When considering compensation arrangements for termination due to circumstances unrelated to default by either party, it may be useful to distinguish exempting impediments from termination declared by the contracting authority for reasons such as public interest or other similar reasons.

(i) Termination due to exempting impediments

44. By definition, exempting impediments are events beyond the parties' control and, as a general rule, termination under such circumstances might not give rise to claims for damages by either party. However, there may be circumstances where it might be equitable to provide for some compensation to the concessionaire, such as fair compensation for works already completed, in particular where, because of the specialized nature of the assets, they cannot be removed by the concessionaire or meaningfully used by it, but may be effectively used by the contracting authority for the purpose of providing the relevant service (e.g. a bridge). However, since termination in such cases cannot be attributed to the contracting authority, the compensation due to the concessionaire may not necessarily need to be "full" compensation (i.e. repayment of debt, equity and lost profits).

(ii) Termination for convenience

45. Where the project agreement recognizes the contracting authority's right to terminate for its convenience, the compensation payable to the concessionaire usually covers compensation for the same items included in compensation payable upon termination for default by the contracting authority (see para. 42), although not necessarily to the full extent. In order to establish the equitable amount of compensation due to the concessionaire, it may be useful to distinguish between termination for convenience during the construction phase and termination for convenience during the operational phase:

(a) *Termination for convenience during the construction phase.* If the project agreement is terminated during the construction phase, the compensation arrangements may be similar to those which are followed in connection with large construction contracts that allow for termination for convenience. In those cases, the contractor is usually entitled to the portion of the price that is attributable to the construction satisfactorily performed, as well as for expenses and losses incurred by the contractor arising from the termination. However, since the contracting authority does not normally pay a price for the construction work carried out by the concessionaire, the main criterion for calculating compensation would typically be the total investment effectively made by the concessionaire up to the time of termination, including all sums actually disbursed under the loan facilities extended by the lenders to the concessionaire for the purpose of carrying out construction under the project agreement, and expenses related to the cancellation of loan agreements. One additional question is whether and to what extent the concessionaire may be entitled to recover lost profit for the portion of the contract that has been terminated for convenience. On the one hand, the concessionaire might have foregone other business opportunities in anticipation of completing the project and operating the facility through the anticipated duration of the concession. On the other hand, an obligation of the contracting authority to compensate the concessionaire for its lost profit might make it financially prohibitive for the contracting authority to exercise its right of termination for convenience. One approach may be for the project agreement to establish a scale of payments to be made by the contracting authority as compensation for lost profits, the amount of the payments depending upon the stage of the construction that has been completed when the project agreement is terminated for convenience. It should be noted, however, that in the contract practice of some countries, government agencies do not assume any obligation to compensate for lost profits when a large construction contract is terminated for convenience;

(b) *Termination for convenience during the operational phase*. As regards the construction work satisfactorily completed by the concessionaire, the compensation arrangements may be the same as for termination for convenience during the construction phase. However, equitable compensation for termination for convenience during the operational phase might require fair compensation for lost profits, which is usually calculated on the basis of the concessionaire's revenue during a certain number of previous financial years. The higher standard of compensation in this case may be justified by the fact that, unlike termination during the construction phase, when the contracting authority might need to undertake to complete the work at its own expense, upon termination during the operational phase the contracting authority might be able to receive a completed facility capable of being operated profitably.

3. Wind-up and transitional measures

46. Where the facility is transferred to the contracting authority at the end of the concession period, the parties may need to make a series of arrangements in order to ensure that the contracting authority will be able to operate the facility at the prescribed standards of efficiency and safety. The project agreement may provide for the concessionaire's obligation to transfer certain technology or know-how required to operate the infrastructure facility (see paras. 47-51). The project agreement may also provide for the continuation, for a certain transitional period, of certain obligations of the concessionaire in respect of the operation and maintenance of the facility (see paras. 52-54). It may further include an obligation, on the part of the concessionaire, to supply or facilitate the supply of spare parts that may be needed by the contracting authority to carry out repairs in the facility (see paras. 55-58).

(a) Transfer of technology

47. In some cases, the facility transferred to the contracting authority will embody various technological processes necessary for the generation of certain goods (e.g. electricity or potable water) or the provision of the relevant services (e.g. telephone services). The contracting authority will often wish to acquire a knowledge of those processes and their application. The contracting authority will also wish to acquire the technical information and skills necessary for the operation and maintenance of the facility. Even where the contracting authority has the basic capability to undertake certain elements of the operation and maintenance (e.g. building or civil engineering), the contracting authority may need to acquire a knowledge of special technical processes necessary to effect the operation in a manner appropriate to the facility in question. The communication to the contracting authority of that knowledge, information and skills is often referred to as the "transfer of technology".

48. Differing contractual arrangements can be adopted for the transfer of technology and the performance of the other obligations necessary to construct and operate the facility. The transfer of technology itself may occur in different ways, for example, through the licensing of industrial property, through the creation of a joint venture between the parties or the supply of confidential know-how. The *Guide* does not attempt to deal comprehensively with contract negotiation and drafting relating to the licensing of industrial property or the supply of know-how, as this subject has already been dealt with in detail in publications issued by other United Nations bodies.[1] The following paragraphs merely note certain major issues concerning the communication of

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[1]The negotiation and drafting of contracts for the licensing of industrial property and the supply of know-how is dealt with in detail in World Intellectual Property Organization, *Licensing Guide for Developing Countries* (WIPO publication No. 620 (E), 1977). The main issues to be considered in negotiating and drafting such contracts are set forth in the *Guidelines for Evaluation of Transfer of Technology Agreements*, Development and Transfer of Technology Series, No. 12 (ID/233, 1979), and in the *Guide for Use in Drawing Up Contracts Relating to the International Transfer of Know-How in the Engineering Industry* (United Nations publication, Sales No. E.70.II.E.15). Another relevant publication is the *Handbook on the Acquisition of Technology by Developing Countries* (United Nations publication, Sales No. E.78.II.D.15).

skills necessary for the operation and maintenance of the facility through the training of the contracting authority's personnel or through documentation.

49. The most important method of conveying to the contracting authority the technical information and skills necessary for the proper operation and maintenance of the works is the training of the contracting authority's personnel. In order to enable the contracting authority to decide on its training requirements, in the request for proposals or during the contract negotiations the contracting authority might request the concessionaire to supply the contracting authority with an organizational chart showing the personnel requirements for the operation and maintenance of the works, including the basic technical and other qualifications the personnel must possess. Such a statement of requirements should be sufficiently detailed to enable the contracting authority to determine the extent of training required in the light of the personnel available to it. The concessionaire will often have the capability to provide the training. In some cases, however, the training may be given more effectively by a consulting engineer or through an institution specializing in training.

50. Technical information and skills necessary for the proper operation and maintenance of the facility may also be conveyed through the supply of technical documentation. The documentation to be supplied may consist of plans, drawings, formulae, manuals of operation and maintenance and safety instructions. It may be advisable to list in the project agreement the documents to be supplied. The concessionaire may be required to supply documents that are comprehensive and clearly drafted, and are in a specified language. It may be advisable to obligate the concessionaire, at the request of the contracting authority, to give demonstrations of procedures described in the documentation if the procedures cannot be understood without demonstrations.

51. The points in time when the documentation is to be supplied may be specified. The project agreement may provide that the supply of all documentation is to be completed by the time fixed in the contract for completion of the construction. The parties may also wish to provide that transfer of the facility is not to be considered completed unless all documentation relating to the operation of the works and required under the contract to be delivered prior to the completion has been supplied. It may be advisable to provide that some documentation (e.g. operating manuals) is to be supplied during the course of construction, as such documentation may enable the contracting authority's personnel or engineer to obtain an understanding of the working of machinery or equipment while it is being erected.

(b) Assistance in connection with operation and maintenance of the facility after its transfer

52. The degree of assistance from the concessionaire needed by the contracting authority with regard to the supply of spare parts and services will depend on the technology and skilled personnel possessed by or available to the contracting authority. If the contracting authority lacks personnel sufficiently skilled for the technical operation of the facility, it may wish to obtain the concessionaire's assistance in operating the facility, at least for an initial period. The contracting authority may, in some cases, wish the concessionaire to provide the personnel to occupy many of the technical posts in the facility, while in other cases the contracting authority may wish the concessionaire only to provide technical experts to collaborate in an advisory capacity with the contracting authority's personnel in the performance of a few highly specialized operations.

53. In order to assist the contracting authority in operating and maintaining the facility, the project agreement may obligate the concessionaire to submit, prior to the transfer of the facility, an operation and maintenance programme designed to keep the facility operating over its remaining lifetime at the level of efficiency required under the project agreement. An operation and maintenance programme would include matters such as an

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For a discussion of transfer of technology in the context of contracts for the construction of industrial works, see *UNCITRAL Legal Guide on Drawing Up International Contracts for the Construction of Industrial Works* (United Nations publication, Sales No. E.87.V.10), chap. VI, "Transfer of technology".

organizational chart showing the key personnel required for the technical operation of the facility and the functions to be discharged by each person; periodic inspection of the facility; lubrication, cleaning and adjustment; and replacement of defective or worn-out parts. Maintenance may also include operations of an organizational character, such as establishing a maintenance schedule or maintenance records. The concessionaire may also be required by the contracting authority to supply operation and maintenance manuals setting out appropriate operation and maintenance procedures. Those manuals should be in a format and language readily understood by the contracting authority's personnel.

54. An effective means of training the contracting authority's personnel in operation and maintenance procedures may be to provide in the project agreement that the personnel of the contracting authority are to be associated with the personnel of the concessionaire in carrying out the operation and maintenance for a certain time prior to or beyond the transfer of the facility. The positions to be occupied by the personnel employed by the concessionaire can then be identified and their qualifications and experience specified. The functions assigned to posts to be filled by employees of the concessionaire need to be defined with particular care. In order to avoid friction and inefficiency, it is desirable that any authority to be exercised by the personnel of each party over the personnel of the other during the relevant period be clearly described.

(c) Supplies of spare parts

55. In projects that provide for the transfer of the facility to the contracting authority, the contracting authority will have to obtain spare parts to replace those which are worn out or damaged and to maintain, repair and operate the facility. Spare parts may not be available locally or from any other source and the contracting authority may have to depend on the concessionaire to supply them. The planning of the parties with respect to the supply of spare parts and services after the transfer of the facility would be greatly facilitated if the parties were to anticipate and provide in the project agreement for the needs of the contracting authority in that regard. However, given the long duration of most infrastructure projects, it may be difficult for the parties to anticipate and provide in the project agreement for the needs of the contracting authority after the transfer of the facility.

56. A possible approach may be for the parties to enter into a separate contract regulating these matters.[2] Such a contract may be entered into closer in time to the transfer of the facility, when the contracting authority may have a clearer view of its requirements. If spare parts are manufactured not by the concessionaire but for the concessionaire by suppliers, the contracting authority may prefer to enter into contracts with those suppliers rather than to obtain them from the concessionaire or, alternatively, the contracting authority may wish to have the concessionaire procure them as the contracting authority's agent.

57. It is desirable for the contracting authority's personnel to develop the technical capacity to install the spare parts. For this purpose, the project agreement may obligate the concessionaire to supply the necessary instruction manuals, tools and equipment. The instruction manuals should be in a format and language readily understood by the contracting authority's personnel. The contract may also require the concessionaire to furnish "as built" drawings indicating how the various pieces of equipment interconnect and how access can be obtained to them to enable the spare parts to be installed and to enable maintenance and repairs to be carried out. In certain cases, it may be appropriate for the concessionaire to be required to train the contracting authority's personnel in the installation of spare parts.

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[2]The Economic Commission for Europe has prepared a *Guide on Drawing Up International Contracts for Services Relating to Maintenance, Repair and Operation of Industrial and Other Works*, which may, *mutatis mutandis*, assist parties in drafting a separate contract or contracts dealing with maintenance and repair of the facility after its transfer to the contracting authority (ECE/TRADE/154).

(d) Repairs

58. It is in the contracting authority's interest to enter into contractual arrangements that will ensure that the facility will be repaired expeditiously in the event of a breakdown. In many cases, the concessionaire may be better qualified than a third person to effect repairs. In addition, if the project agreement prevents the contracting authority from disclosing to third persons the technology supplied by the concessionaire, this may limit the selection of third persons to effect repairs to those who provide assurances regarding non-disclosure of the concessionaire's technology that are acceptable to the concessionaire. On the other hand, if major items of equipment have been manufactured for the concessionaire by suppliers, the contracting authority may find it preferable to enter into independent contracts for repair with the suppliers, as they may be better qualified to repair the items. In defining the nature and duration of repair obligations imposed on the concessionaire, if any, it is advisable to do so clearly and to distinguish them from obligations assumed by the concessionaire under quality guarantees to remedy defects in the facility.